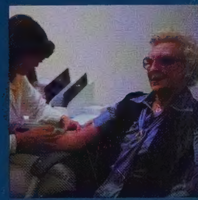
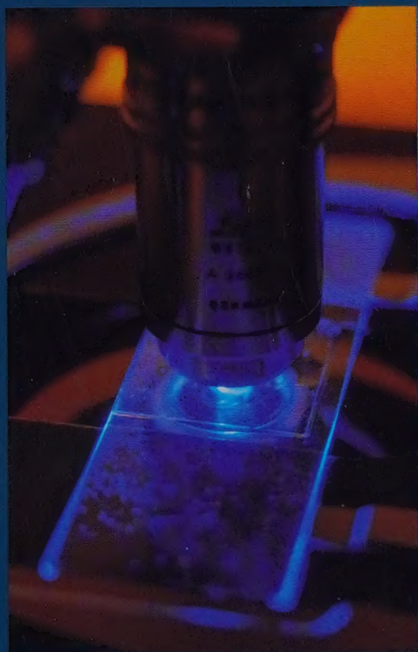
MDS Health Group Limited

Annual Report 1980





(Cover Photo) Fluorescent microscopy is a commonly performed procedure in MDS Laboratories and like many laboratory procedures requires a high level of interpretive skills. People - their attitudes, their dedication to excellence, their willingness to work together - are perhaps more essential than in most other firms or fields of endeavour. The people of MDS have brought together their business, professional and scientific skills and interests to create a stimulating and effective working relationship. This is reflected in the high standards of quality in the company's services and procedures which touch every segment of the population, both young and old.

Annual Meeting

Shareholders are invited to attend the company's Annual and Special Meeting at 4 p.m., April 28, 1981 in the Confederation Room of the Royal York Hotel, Toronto, Ontario.

MDS - Serving and Caring

MDS Health Group combines scientific and technological capabilities with efficient business administration to provide a range of health care and related services in both Canada and the United States.

The corporation operates a network of diagnostic laboratories providing clinical testing services to physicians, hospitals, convalescent care centres, veterinarians and industry. Innovative approaches and an emphasis both on speed and on a high level of quality control have enabled the company to attract and retain many thousands of clients, including a large number who had previously relied on services within their own organizations.

MDS also provides preventive and occupational health programs to business and industry; manufactures diagnostic reagents and microbiological media; services diagnostic equipment; distributes scientific and other related products; and has begun operating centres to assist children with learning disabilities.

The committed team of MDS people – scientists, technologists, administrators and support staff – has helped to create a vital, growing organization which is making an ever-increasing contribution in the support of physicians and institutions dedicated to saving lives, preserving health and contributing to the improvement of the quality of life.

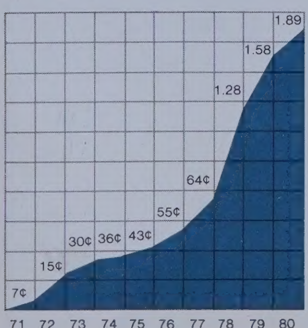
1980 Financial highlights

The year in review	*1980*	*1979*	*% Change*
Revenues	$47,702,000	$39,698,000	+20.2%
Depreciation and amortization	1,461,000	1,169,000	+25.0%
Income taxes	2,378,000	2,334,000	+ 1.9%
Income before extraordinary item	2,812,000	2,240,000	+25.5%
Earnings per share*†	$ 1.89	$ 1.58	+19.6%
Total assets employed	30,426,000	28,660,000	+ 6.2%
Shareholders' equity	11,404,000	9,120,000	+25.0%
Dividends paid per share†	$ .35	$ .30	+16.7%

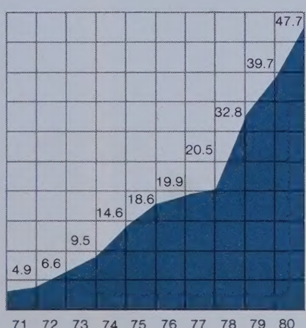
* Fully diluted but before extraordinary item
† Combined total of Class A Common and Class B Preferred in 1980

A ten year record of growth: 1971 - 1980

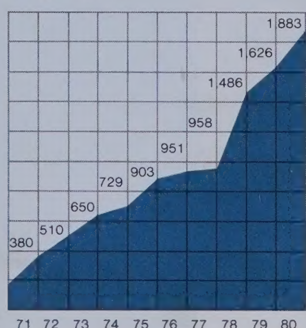
Earnings per Share†*



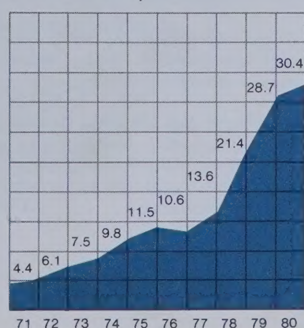
Revenues in millions



Total Employees



Total assets in millions



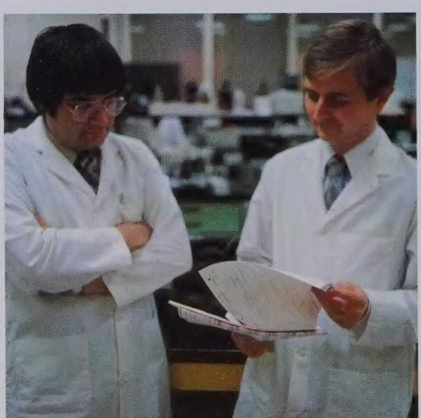
* Fully diluted but before extraordinary item
† Combined total of Class A Common and Class B Preferred in 1980

The dedication and effective efforts of MDS professionals make possible the high quality of MDS services and the continued growth of the company.

(Above) Kate Wray, R.T. performs microscopic examinations.

(Right) Gord Whiteley, Ph.D., Microbiologist and Tom England, Ph.D., Clinical Chemist review laboratory results.

(Far Right) Bel Conover, Co-ordinator and Tim Gilmor, Ph.D., Psychologist and Director of the Bloor/Jane Tomatis Centre combine their professional talents to help children with learning problems.



To Our Shareholders:

MDS Health Group during the 1980 fiscal year continued to grow in its established areas of business, while extending the activities of its newer enterprises. Net income before extraordinary item increased 26 percent on a 20 percent increase in revenue, and earnings per share increased 20 percent.

These results were achieved even though the continuing cost pressures of inflation were not offset by a comparable increase in laboratory fees. As a matter of fact, private laboratories in Ontario, MDS' major laboratory base, have been able to handle the increasing demand for outpatient laboratory testing so effectively over the last five years that average laboratory fees increased by less than half the rate of inflation. With the continuing pressure on health care costs the proven ability of private laboratories to take on additional work at a lower cost will become increasingly significant.

Particularly encouraging in the last year were both the continued growth and improved operating performance of the MDS Laboratory division in the United States. Laboratory revenue increased by 45 percent and operations in the United States now account for one-fifth of the company's revenue. This increase in revenue was equally divided between the internal expansion of existing laboratories and the acquisition of five new community laboratories. Internal growth was experienced in each region in which the company provides a service. The MDS network in New York, Pennsylvania and New Jersey now includes 25 locations. The company, encouraged by its continued success in the United States, is examining opportunities for acquiring or establishing additional laboratories in regions contiguous to those in which it now has a presence.

In late 1978, MDS began working with Dr. Alfred A. Tomatis in the evaluation of the Tomatis method for assisting children and others with learning disabilities. While the observable results of the program are impressive, the company is conscious of the need to provide statistical and psychological data as further evidence of the validity of the program offered by the Tomatis Centres. One independent study has been undertaken at the company's request, and others are being planned. The third Tomatis Centre was opened during the year. It is located in Montreal.

Operating results for the National Scientific division improved in fiscal 1980, but continue to be less than satisfactory. Revenue was lower than expected, due to a declining high school science market which has been severely affected by both lower enrollment and budgetary constraints. Because of the declining demand, certain inventory owned by National Scientific was written down to its estimated net realizable value. This write down of approximately $450,000 after tax was partially offset by a non-taxable gain of $411,000 which resulted when the former part owner of National Scientific surrendered his Class B shares for cancellation.

At a Special Meeting on September 17, 1980 the shareholders of the company approved the creation of two new classes of shares, a Class A Common and Class B Preferred, and the reclassification and exchange of one Class A Common share and one Class B Preferred share for each existing common share outstanding. The Class B Preferred share is similar to the Class A Common share in all respects except it has a preferential yearly dividend of 10¢ per share and is non-voting. Following this share reorganization the Board of Directors approved a dividend of 7½¢ per share on the Class A Common shares and a dividend of 12½¢ on each Class B Preferred share. This was in addition to the previous dividend of 15¢ per common share paid in April.

1980 was a year of good progress for MDS.

The Directors express their thanks to the company's employees and professional consultants. Their dedication and effective efforts have made possible the high quality of MDS services and the continued growth of the company.

W. G. Lewitt
President

January 22, 1981

MDS capabilities and services parallel emerging trends and support health professionals in their efforts to help children, the aging population and the employee in the work place to live better lives.

(Above) Kris Jeswani, R.T. performs 'assays' to monitor the influence of hazardous substances on the health of workers.

(Right) Since October 1978 MDS has been working with Dr. A. A. Tomatis to provide assistance for children with listening-based learning disabilities.

(Far Right) Physicians refer more than 1.5 million patients to MDS laboratory centres annually. The aging population will understandably require increased diagnostic services.

The Business Environment

A Current Overview and a Look Ahead

Some interesting emerging trends in Canada and the United States are closely paralleled by the capabilities and service potential of MDS. Health care professionals are constantly seeking lower-cost alternatives to the traditional high-cost methods of health care; there is greater emphasis on prevention of illness or on its early detection through testing programs; governments, employers, unions and individuals are increasingly alert to hazards in the workplace and in the environment; and a population whose average age is increasing steadily creates additional demands for an increasing range and volume of diagnostic services. MDS is well positioned to respond.

Health protection for employees in the workplace requires specific identification of hazardous substances as well as the continual monitoring of the impact of such substances on the health of workers. The variety of these substances, the increasing technological and scientific ability to detect not only the physical presence of such substances, but their immediate pathological consequences and their more distant cancer-related and other effects, mean an ever widening, ever more subtle and ever more frequent use of laboratory procedures.

The North American population is aging. Today, nine percent of Canadians and Americans are 65 and over, twenty-two million, five hundred thousand in a continental population of two-hundred and fifty million. By the year 2000, persons over 65 will constitute 12 percent of the total Canada-U.S. population, or thirty-six million in a total population of three hundred million. This aging population will understandably require increased diagnostic services. More significantly, this change in the demographic composition of the population will have a major social, political and economic impact on government policies, particularly health and social welfare spending patterns. Rising costs will shift the emphasis from intensive in-hospital care to early diagnosis, out-patient services and preventive health care.

Services to Help People Stay Healthy

There is an undisputed link between environment and health. MDS provides more than 800 companies in Canada and the United States with a wide range of health assessment testing services designed to help keep employees healthy. The services offered include pre-employment and periodic health assessments to establish fitness for employment and detect any impact of health hazards in the workplace; the regular screening of workers exposed to hazardous substances; the diagnosis and treatment of occupational injuries and diseases; and rehabilitation assistance. Recent regulatory developments indicate clearly that in the future the occupational health field will offer an expanded role for MDS.

A Program to Help Children Achieve Their Learning Potential

As school populations decline in the 1980's, educators will search for new programs and new technologies that help children with the learning process. Particularly significant is the passing of legislation in both the United States and Canada oriented towards the early identification of children with dyslexia and other learning disabilities. Since October 1978, MDS has been working with Dr. A. A. Tomatis, in providing assistance to children with certain learning disabilities.

Various North American and European studies indicate that between ten and fifteen percent of the children in the five to fourteen year age bracket have some degree of learning disability. Only a small percentage — those severely affected — are currently being served by existing private and public institutions. In the last two years, centres under Dr. Tomatis' professional direction have selectively treated children for listening problems. With continued favourable results, there appears to be a growing awareness of the Tomatis concepts and an increasingly favourable response from concerned parents, professionals and institutions.

Research and Development

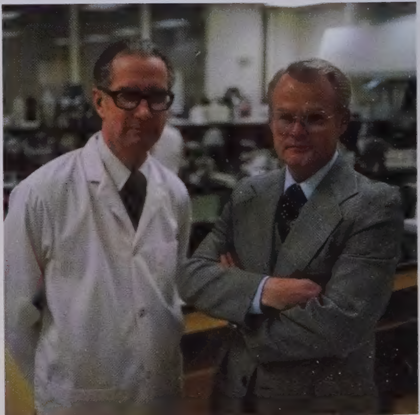
In association with the National Research Council of Canada and other Government research groups, MDS is developing easily performed immunochemical procedures for the detection of gonorrhea, and is conducting fundamental research work in the development of simple tests for the detection of the sexually-transmitted form of Chlamydia, a prevalent disease and one which is presently difficult to detect. MDS has also entered into an agreement with a prominent Canadian immunologist to conduct research aimed at the development of antibodies of a higher specificity than can now be produced by conventional techniques. These 'monoclonal antibodies' could lead to the production of more reliable reagents for a variety of immunochemical procedures.

MDS laboratories are equipped with some of the most advanced equipment of its type, but it is the capability and commitment of MDS consultants and employees, not the sophistication of MDS equipment, that account for the quality of MDS services.

(Above) Cheryl Davenport, R.T. examines microbiological specimens for biochemical reactions.

(Right) Alla Dueck, A.R.T., and Sue Linnell, R.N. bring together their individual skills to deal with administrative matters in the laboratory.

(Far Right) John Nixon, M.D., Ph.D., Medical Director of MDS Laboratories in Ontario and Glenn Cahilly, Ph.D., Vice-President of MDS Laboratories U.S. operations, are but two of the more than 60 laboratory physicians and scientists associated with MDS Laboratories in the United States and Canada.



Review of Operations

MDS Laboratory Divisions

MDS Laboratories is one of the ten largest providers of medical laboratory testing services in North America. The clinical laboratory testing field is intensely competitive and highly fragmented both in the United States and in Canada. No single laboratory organization accounts for more than one percent of the total North American expenditures - estimated to be in excess of 15 billion dollars and growing at the rate of 15 percent per year.

MDS clinical laboratories provide a total diagnostic service to more than 5000 physicians and 300 hospitals through 127 community laboratories and patient centres organized into a network of regional laboratory systems located in New York, Pennsylvania and New Jersey in the United States and in Ontario in Canada. The core of each regional system is a central, automated reference laboratory offering automated profiles, routine tests and more complex procedures in the various laboratory disciplines.

Three operating principles that differentiate MDS from other laboratories of its size are the company's commitment to doing as much testing as possible in the communities in which their clients are located; to transporting specimens to its laboratories exclusively by company-owned carriers, which have full control over the integrity of the samples being transported; and to operating all of its facilities under the direct supervision of a qualified laboratory physician.

MDS believes that a combination of the skills of the pathologist, the scientist and the professional administrator working together in the community being served is the key to long-term success in the demanding and rapidly changing laboratory field.

Ontario Division:

The billings of private laboratories to the Government of Ontario represent approximately two per cent of the Province's annual health care budget.

With its network operating in more than fifty cities and towns, MDS provides more outpatient medical testing in the Province of Ontario than any other laboratory. MDS is also a major reference laboratory resource for hospitals. In 1980 the demand for services continued to grow as an increasing number of physicians selected MDS for their diagnostic testing requirements.

In the last five years private laboratories in Ontario have been clearly established as the low-cost provider of outpatient laboratory services as average fee increases of four percent have been less than one-half the average rate of inflation and substantially less than the funding increases provided to public hospitals.

To combat inflationary pressures, reflected in higher costs for such things as materials, building occupancy and salaries, MDS continued in 1980 to turn to improved technology and management controls to effect operational efficiencies. In addition to systems improvements, an increase in the number of reagents manufactured for internal consumption and the increasing purchasing power of MDS operations provided the basis for internal cost savings in 1980. In 1981 MDS will continue with efforts to build volume and wherever possible streamline operations in its steady fight against inflation.

In fiscal 1980 MDS continued its equipment purchase and replacement programs in order to remain current with technological change. Increased automation, combined with improvements in operating procedures, provided ongoing productivity improvements.

MDS has always maintained a rigid quality control program. This was further enhanced in the past year with computerization and the institution of supportive reporting controls. In addition to the proficiency testing program administered by the government, MDS has utilized its professional and technical expertise to develop its own blind control programs in the various laboratory disciplines. MDS is one of the few laboratories in Canada to enjoy accreditation by the College of American Pathologists.

United States Division:

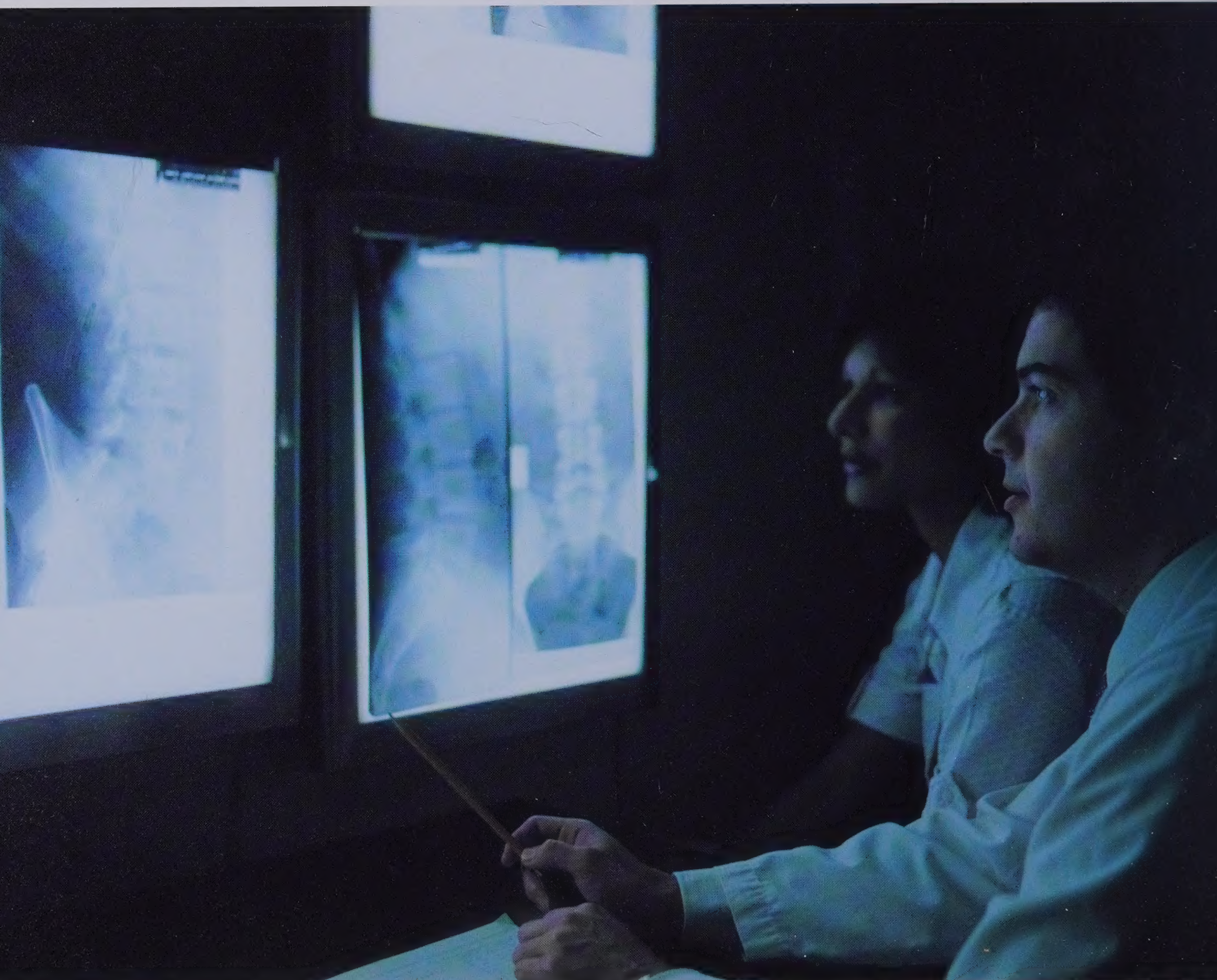
The market for medical laboratory services is divided among 7000 hospital laboratories, 50,000 physicians' office laboratories and 6000 independent commercial laboratories. Hospital laboratories account for 40 percent of the testing volume and receive 50 percent of the testing revenue. Physicians' office laboratories account for 20 percent of the testing volume and receive 25 percent of the testing revenue and independent laboratories account for 40 percent of the testing volume and receive 25 percent of the testing revenue.

Proposed new legislation, the emphasis on cost containment and stricter regulation of hospital and physicians' office laboratories have created an environment in which high-service, lower-cost independent laboratories like MDS will secure an increasingly larger share of the overall testing service.

There is a trend to consolidation in the United States. The number of independent laboratories has been reduced by half since 1979, but there are still substantial opportunities for consolidation. No one company has even one percent of the total business and the combined revenues of the top ten companies amount to less than five percent of the total.

The momentum developed by MDS in 1979 continued into 1980. Per diem

MDS is continuing to extend its capabilities both into the manufacture and distribution of clinical laboratory products and into the provision of paramedical services to industry.



(Above) Barry Kurtzer, M.D. and Adarsh Phull, R.T.R. review x-rays of an employee of one of the more than 700 companies utilizing MDS' occupational health services.

(Right) Karen Barker, R.N. treats a worker injured in an industrial accident.

(Far Right) Microbiological media culture plates as well as other products are manufactured by MDS.

revenues increased by 49 percent during the year. Internal growth accounted for 23 percent and the acquisition of five community laboratories for the other 26 percent. Internal growth occurred in all markets, reflecting recognition of the company's operating philosophies and capabilities in the communities and markets being served.

Management emphasis in 1980 focussed on the integration of the growth of the last two years. In May of 1980 a new regional facility was opened in Reading, Pennsylvania, to service community laboratories in eastern Pennsylvania and southern New Jersey. Laboratory operations previously located in Bernville, Pennsylvania, and Holmdel, New Jersey, were consolidated at this new location.

At the regional reference laboratory in Olean, New York, a computer system was installed to log and monitor testing within the laboratory, to perform numerous administrative functions, and to transmit results to distant laboratory locations when required.

In 1980 programs were initiated through the Medical Executive Committee of MDS to standardize the methods in the various MDS laboratories in the United States. An immediate benefit of this program was the significantly reduced material costs achieved in the fiscal period.

Internal growth is expected to continue at about 20 percent per year and it is expected that additional community laboratories will be added to the network in the three-state area now being serviced.

MDS Supplies Division

National Scientific provides distribution of products to the clinical, industrial and educational markets across Canada.

During 1980, the increase in this division's revenues was insufficient to provide a satisfactory return on assets employed. Declining school enrollments and budgetary constraints resulted in significantly lower revenues in the educational market which more than offset the progress made in the doubling of clinical sales. The clinical market now represents the largest segment of National's business. Action has been taken to generate improved results for the next fiscal period, including price revisions, the negotiation of new exclusive product lines and the expansion of the service to new areas.

The manufacture, purchase and distribution of products for MDS Laboratories is carried out by OCW Diagnostics. This operation is vertically integrated with the laboratories division and hence its growth is closely related to the growth of the latter. MDS research and development done in conjunction with the National Research Council of Canada is expected to produce diagnostic products that will augment the Supplies Division's overall growth and profitability.

MDS Health Care Services

MDS Health Care Services operates only in Canada, although certain MDS health care services are available in the United States through the MDS Laboratory Division. Executive Health Clinics in Toronto and Montreal provide a wide range of health assessment programs for the employees of over 700 companies. MDS nurses in major cities across Canada carry out more than 60,000 paramedical examinations on policy applicants for the Canadian life insurance industry through a mobile service. The Evans Medical Industrial Clinic provides a wide range of occupational health services to some 400 companies in the Metropolitan Toronto area.

The outlook for MDS Health Care Services continued to improve in 1980 both because of the increasing awareness of employee health and well-being by business and industry and because of steps taken to deal with inflationary pressures. Improved systems, increased market penetration and higher fees resulted in better overall performance even though client volume was affected by the economic slowdown and the cost of medical supplies was significantly higher.

The Ontario Occupational Health and Safety Act passed in 1978 has not yet come into effect. Its regulations are making industry more sensitive to the need for service, but are not yet compelling compliance. As the regulations come into force, the Health Care Services Division will be able to expand more rapidly in both the number and the range of services offered.

Tomatis Centres provide a new direction for MDS and new hope for those children and adolescents who have a listening based learning disability.

(Above) Shona Hurring, Therapeutic Assistant, works with a child during therapy session at Tomatis Centre.

(Right) Alfred A. Tomatis, M.D., originator of the Tomatis Method is active in the overall direction of the Tomatis Centres and is shown here with one of the many children being helped to overcome a learning disability.

(Opposite Page) Michele Anderson, Therapeutic Assistant, makes adjustments to Tomatis electronic apparatus which provides individualized listening therapy to children and adolescents on the program.

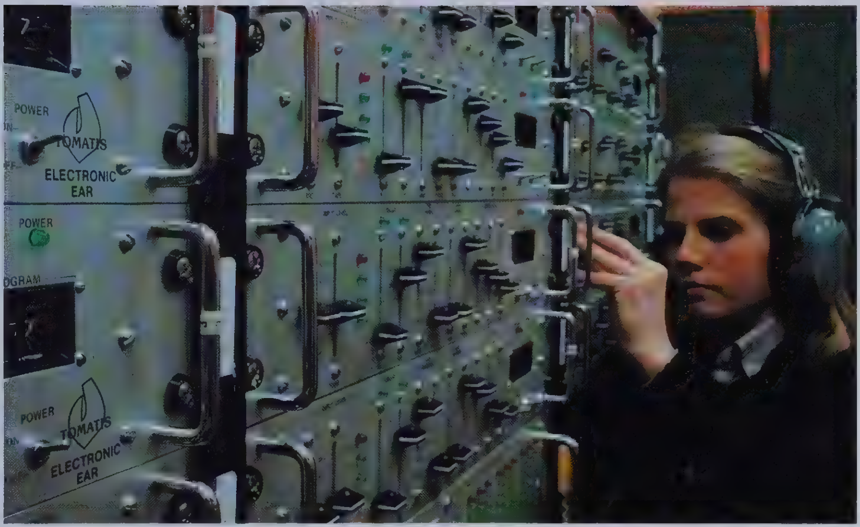
Tomatis Centres

The company continued, in the 1980 fiscal year, the development of its Tomatis Centres and the application of the Tomatis Method to assist children - and some adolescents and adults as well - who suffer learning disabilities. A third Tomatis Centre was opened in Montreal during the year.

The experience of Dr. Tomatis, originator of the Tomatis Method of assessing and assisting persons with learning disabilities, is that in some cases the individual's difficulties arise from a failure or an inability to listen to certain parts of the sound spectrum. A fundamental element in the Tomatis theory is that this results in a distorted or inadequate perception of what reaches the ear. This distortion or inadequacy is reflected in various communications-related aspects of the individual's life, including the ability to read with comprehension and to write coherently. Studies in Europe and North America have shown that an estimated 10 to 15 percent of children are affected to some degree by learning disabilities.

A distinction is made between the ability to hear and the ability to listen. Unlike a loss of hearing, a listening impairment can be corrected by an integrated program of auditory stimulation and psychological counselling. The Tomatis Method is not an educational process. It is an adjunct to, and complements the educational process.

During the last year, positive results were achieved for children and adults with learning problems who participated in the program. Because of these positive results, additional professionals in the field of learning disabilities became involved with the



program as members of the Tomatis Professional Advisory Board and are now actively working with Dr. Tomatis and MDS.

This body, with Dr. Alfred Tomatis and Dr. William Anderson, Chairman of the MDS Medical Advisory Committee, acting as Co-Chairmen, is responsible for directing the professional policies of this program. It has established guidelines for effective quality control of clinical procedures, as well as for on-going research. One result is the establishment of an independent research program with an Ontario university to augment the internal studies of this new approach to learning problems.

Internal studies are based on a formal follow-up on the children and adolescents who have been on the program. Response has been most encouraging. A significant majority of parents indicate lasting improvements in concentration, comprehension, self-confidence and attitude, as well as academic skills.

Through parent seminars and presentations to teachers, psychologists and professionals, communication lines have been opened to assist these members of the community in a better understanding of the Tomatis Method and its potential applications to aid individuals with communication and learning problems.

Like the two centres in Toronto, the new Montreal centre is under the direction of Dr. Tomatis and his clinical specialists.

Responsibility for Financial Statements

Management

The accompanying consolidated financial statements of MDS Health Group Limited have been prepared by management in accordance with generally accepted accounting principles consistently applied. The most significant of these accounting principles have been set out in note 1 to the financial statements. These statements are presented on the accrual basis of accounting and, accordingly, a precise determination of many assets and liabilities is dependent upon future events which necessarily involves the use of estimates and approximations which have been made using careful judgement. In recognizing that the corporation is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these financial statements have been prepared with this in mind and within reasonable limits of materiality.

The Board of Directors has appointed an Audit Committee consisting of non-management directors. The committee meets periodically during the year to review with management and the auditors any significant accounting and auditing matters and to review and finalize the annual financial statements of the corporation along with the independent auditors' report prior to the submission of the financial statements to the Board of Directors for final approval. The Audit Committee also reviews any major weaknesses in the corporation's systems of internal control reported by the auditors.

The financial information throughout the text of this Annual Report is consistent with the information presented in the financial statements.

The corporation's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable.

External Auditors

The auditors' opinion is based upon an independent and objective examination of the corporation's financial results for the year conducted in accordance with generally accepted auditing standards. This examination includes an understanding and evaluation by the auditors of the corporation's accounting systems and internal control procedures as well as obtaining a sound understanding of the corporation's business. The external auditors conduct appropriate tests of the corporation's transactions and obtain sufficient audit evidence in order to provide them with reasonable assurance that the financial statements are presented fairly in accordance with generally accepted accounting principles thus enabling them to issue their report to the shareholders.

Clarkson Gordon, Chartered Accountants, having been appointed by the shareholders of the corporation to serve as the corporation's external auditors, have examined the consolidated financial statements of the corporation for the year ended October 31, 1980 and have reported thereon in their report set out below which is dated January 5, 1981.

Auditors' Report

**To the Shareholders of
MDS Health Group Limited:**

We have examined the consolidated balance sheet of MDS Health Group Limited as at October 31, 1980 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the corporation as at October 31, 1980 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year, after giving retroactive effect to the change in accounting for leases as set out in note 11(a) to the consolidated financial statements.

Clarkson Gordon
Chartered Accountants

*Mississauga, Canada,
January 5, 1981.*

Consolidated Financial Statements
Year Ended October 31, 1980

Consolidated Statement of Income
Year Ended October 31, 1980
(with comparative figures for 1979)

	1980	1979 (as restated — note 11(a))
Revenues, net of discounts	$47,702,000	$39,698,000
Operating costs before the following:	39,751,000	33,073,000
Depreciation and amortization	1,461,000	1,169,000
Interest expense — long term debt	1,388,000	917,000
— other (income)	(193,000)	164,000
Foreign exchange	105,000	81,000
	42,512,000	35,404,000
Income before income taxes, minority interest and extraordinary item (note 5)	5,190,000	4,294,000
Provision for income taxes	2,378,000	2,334,000
Income before minority interest and extraordinary item	2,812,000	1,960,000
Minority interest share of loss		280,000
Income for the year before extraordinary item	2,812,000	2,240,000
Extraordinary item:		
Loss on sale of a Quebec division		114,000
Net income for the year	$ 2,812,000	$ 2,126,000
Fully diluted earnings per share before extraordinary item (note 4(d)):		
Class A Common	$.92	$.77
Class B Preferred	.97	.81
Fully diluted earnings per share for the year (note 4(d)):		
Class A Common	.92	.73
Class B Preferred	.97	.77

(See accompanying notes)

Consolidated Statement of Retained Earnings
Year Ended October 31, 1980
(with comparative figures for 1979)

	1980	1979
Retained earnings, beginning of year	$5,470,000	$3,793,000
Net income for the year	2,812,000	2,126,000
Dividends paid during the year	(528,000)	(449,000)
Retained earnings, end of year	$7,754,000	$5,470,000

(See accompanying notes)

Consolidated Balance Sheet

October 31, 1980
(with comparative figures as at October 31, 1979)

Assets	1980	1979 (as restated — note 11(a))
Current assets:		
Cash and short term investments	$ 3,504,000	$ 4,155,000
Accounts receivable (note 3)	9,682,000	8,182,000
Inventory (note 3)	3,157,000	3,632,000
Prepaid expenses	673,000	556,000
Current deferred income taxes	552,000	45,000
Future income tax reductions		631,000
	17,568,000	17,201,000
Fixed assets (notes 3 and 6)	6,109,000	5,044,000
Other assets (note 7)	607,000	800,000
Excess of amounts paid over the fair value of the net tangible assets acquired on the purchases of shares and assets, less amortization and write-off	6,142,000	5,615,000
	$30,426,000	$28,660,000

On behalf of the Board:

Director

Director

Liabilities and Shareholders' Equity

	1980	1979 (as restated — notes 2 and 11(a))
Current liabilities:		
Bank indebtedness (note 3)	$ 1,138,000	$ 1,323,000
Accounts payable and accrued liabilities	4,381,000	3,851,000
Current portion of long term debt (note 3)	492,000	681,000
Income and other taxes payable	2,280,000	2,644,000
	8,291,000	8,499,000
Long term debt (note 3)	10,552,000	10,880,000
Deferred income taxes	179,000	161,000
Shareholders' equity:		
Share capital (note 4)	3,650,000	3,650,000
Authorized:		
An unlimited number of convertible Class A Common shares		
An unlimited number of non-voting Class B Preferred shares		
An unlimited number of 8% cumulative, convertible Class C Preferred shares, redeemable for $5 per share		
Issued:		
1,338,962 Class A shares		
1,366,184 Class B shares		
133,512 Class C shares		
Retained earnings	7,754,000	5,470,000
	11,404,000	9,120,000
	$30,426,000	$28,660,000

(See accompanying notes)

Consolidated Statement of Changes in Financial Position

Year Ended October 31, 1980
(with comparative figures for 1979)

	1980	1979 (as restated — note 11(a))
Funds were provided from:		
Operations —		
Income before minority interest and extraordinary item	$ 2,812,000	$ 1,960,000
Add charges not requiring an outlay of working capital:		
Depreciation and amortization	1,390,000	1,099,000
Amortization of goodwill	71,000	70,000
Deferred income taxes	18,000	125,000
Amortization of deferred foreign exchange loss	40,000	70,000
Provision for doubtful realization of other assets	80,000	30,000
Funds provided from operations	4,411,000	3,354,000
Reduction in other assets	65,000	—
Proceeds on disposal of fixed assets	230,000	—
Issue of long term debt	—	4,198,000
Proceeds on disposal of a Quebec division	—	89,000
Total funds provided	4,706,000	7,641,000
Funds were applied to:		
Invest in subsidiaries (less working capital and fixed assets acquired)	598,000	225,000
Purchase fixed assets	2,677,000	2,580,000
Reduce long term debt over one year	328,000	402,000
Pay dividends	528,000	449,000
Increase other assets	—	187,000
Total funds applied	4,131,000	3,843,000
Increase in working capital	575,000	3,798,000
Working capital, beginning of year	8,702,000	4,904,000
Working capital, end of year	$ 9,277,000	$ 8,702,000
Represented by:		
Current assets	$17,568,000	$17,201,000
Current liabilities	8,291,000	8,499,000
	$ 9,277,000	$ 8,702,000

(See accompanying notes)

Notes to Consolidated Financial Statements
October 31, 1980

1. Accounting policies
The corporation follows generally accepted accounting principles, the most significant of which are as follows:

(a) Basis of consolidation –
The accounts of all subsidiaries are consolidated on a purchase basis from the date of acquisition.

(b) Fixed assets –
Fixed assets are carried in the accounts at cost. Gains or losses arising on the disposal of individual assets are recognized in income in the year of disposal.

Assets leased by the corporation under agreements which transfer substantially all of the benefits and risk of ownership of the assets to the corporation are accounted for as capital leases.

Depreciation is generally provided on a straight-line basis over the estimated useful lives of assets at annual rates as follows:

Buildings	– 4%
Major equipment	– 20%
Other equipment, furniture and fixtures	– 10%
Leasehold improvements	– Lesser of 10% or the term of the lease plus one renewal period

(c) Inventories–
Inventories are valued at the lower of cost and net realizable value on the average cost basis for the distribution division and on the first-in, first-out basis for the other divisions.

(d) Development and start-up costs –
Costs associated with development of new products and locations and with the acquisition of new business are expensed as incurred.

(e) Amortization of intangibles –
For acquisitions after March 31, 1974, the excess of amounts paid over the fair value of the net tangible assets (also referred to as goodwill in these financial statements) acquired on the purchase of shares and assets is capitalized and is being amortized over periods not exceeding forty years. For acquisitions prior to April 1, 1974 the excess has been capitalized and no amounts are being amortized.

(f) Debt issue expense –
Debt issue expense is amortized over the term of the debt.

(g) Building investments –
In prior years, the corporation had made investments in building projects. At the year end, these investments have been recorded as non-current assets at cost less allowance for doubtful realization in the corporation's financial statements. When there is reasonable expectation of realizing the present holdings within the next fiscal year, such holdings are reclassified as current assets. It is not the corporation's intention to take a long term controlling investment position in building projects.

(h) Income taxes –
The corporation follows the deferral method of income tax allocation. Deferred income taxes result from differences between amounts claimed for tax purposes and amounts charged in the accounts. Where the corporation is virtually certain of realizing a future income tax reduction from a loss for tax purposes incurred in the reporting period, such future income tax reduction is recognized in the accounts in the current year.

(i) Exchange translation –
The statements of companies whose accounts are maintained in U.S. dollars have been translated into Canadian dollars substantially as follows: inventories, fixed assets, goodwill, deferred income taxes and related expenses, at historic rates of exchange; all other assets and liabilities, at exchange rates prevailing at the end of the year; income and expenses (other than those related to assets and liabilities translated at historic rates) at average rates for the year. Translation gains or losses are included in income except for unrealized losses on long term debt which are deferred and charged to income over the unexpired term of the debt.

(j) Earnings per share –
Earnings per share have been calculated using the weighted monthly average number of shares outstanding during the year. Fully diluted earnings per share have been calculated on the assumption that each Class C share outstanding at the year end had been converted into one Class A Common and one Class B Preferred share at the beginning of the year.

2. Restatement of prior year's figures
1979 long term debt has been increased by $411,000 to reflect a reclassification of the Class B Preferred share indebtedness which was previously recorded in shareholders' equity. This change in 1980 arose from a reconsideration by management of the characteristics of the Class B Preferred shares, which concluded that it was more appropriate to classify the shares as debt because the redemption value of these shares was dependent upon the future profitability of one of the corporation's divisions.

3. Long term debt

	Maturity	Current portion	Total 1980	Total 1979
Canadian operations:				
1979 Debentures	1999	$128,000	$ 9,888,000	$10,000,000
Obligations under capital leases	1981-1984	195,000	420,000	419,000
Non-interest bearing debt (note 5)				411,000
Notes and mortgages (interest varies from 8% to 12¼%)	1981-1998	13,000	303,000	449,000
		336,000	10,611,000	11,279,000
U.S. operations (in Canadian dollars): Notes and mortgages (interest varies from 6% to 9¾%)	1981-1986	156,000	433,000	282,000
		$492,000	11,044,000	11,561,000
Less current portion			492,000	681,000
			$10,552,000	$10,880,000

The 1979 debentures bear interest at a fixed rate of 13% to October 31, 1981 and thereafter at a floating rate of 1⅜% over the prime rate (with a minimum rate of 10% and a maximum rate of 13¼%). The debentures are repayable in monthly payments of principal and interest over a nineteen year period.

The 1979 debentures have been collateralized by a fixed and floating charge debenture issued by the parent company and its U.S. subsidiary. Under the terms of the debenture the corporation may pledge its accounts receivable and inventory as security for short term bank borrowings provided total bank borrowings are at least $1,000,000 less than the book value of current assets.

In addition to the 1979 debentures, the corporation has an operating line of credit of $6,000,000 with a Canadian chartered bank for which a specific charge on accounts receivable and inventory has been given. At October 31, 1980, $1,115,000 has been advanced to the corporation as a demand loan in connection with this line of credit.

Principal repayments required in the next five fiscal years are:
1981 - $492,000
1982 - 532,000
1983 - 420,000
1984 - 286,000
1985 - 240,000

At October 31, 1980, the corporation has satisfied all covenants under the trust deed relating to the debentures.

4. Share capital

(a) Restructure of authorized share capital –
At a special meeting held on September 17, 1980, the shareholders of the corporation approved certain changes to the capital structure of the corporation resulting in new authorized share capital which now consists of:
(i) An unlimited number of convertible Class A Common shares.
(ii) An unlimited number of non-voting Class B Preferred shares.
(iii) An unlimited number of 8% cumulative, convertible Class C Preferred shares, redeemable for $5 per share.

The Class A Common and Class B Preferred shares are identical to each other in all respects except that:
(i) The Class B Preferred shares are non-voting.
(ii) The Class B Preferred shares entitle the shareholders thereof to non-cumulative dividends of $.05 per share in each half fiscal year of the corporation before any dividends on the Class A Common shares.
(iii) After declaration of the preferential dividends in each half fiscal year, the Class A Common and Class B Preferred shares participate equally in all further dividends during that half fiscal year.
(iv) The Class A Common shares are convertible into Class B Preferred shares on a one for one basis. The Class B Preferred shares are not convertible into Class A Common shares.

Each Class C Preferred share is convertible into one Class A Common and one Class B Preferred share.

(b) Conversion of previously issued share capital –
(i) Each issued and outstanding common share was subdivided into one Class A Common share and one Class B Preferred share.
(ii) The former Class A shares became Class C Preferred shares.

(c) Summary of share capital –

	Issued as a result of change in capital structure	*Conversion of Class A*	*Conversion of Class C*	*Total*
Class A shares –				
Number	1,344,039	(13,611)	8,534	1,338,962
Amount	$1,602,000	$(16,000)	$ 23,000	$1,609,000
Class B shares –				
Number	1,344,039	13,611	8,534	1,366,184
Amount	$1,338,000	$ 16,000	$ 20,000	$1,374,000
Class C shares –				
Number	142,046	—	(8,534)	133,512
Amount	$710,000	—	$(43,000)	$ 667,000
Total amount of issued share capital	$3,650,000	—	—	$3,650,000

(d) Earnings per share –
Fully diluted earnings per share for the year ended October 31, 1979 have been restated to reflect the subdivision of each of the previously issued common shares into one Class A Common share and one Class B Preferred share on the same basis as the current year and the allocation of preferential dividends of $.05 per Class B Preferred share. On the same basis, basic earnings per share are as follows:

	1980	*1979*
Basic earnings per share before extraordinary item:		
Class A Common	$1.00	$.83
Class B Preferred	1.05	.88
Basic earnings per share for the year:		
Class A Common	1.00	.78
Class B Preferred	1.05	.84

If the subdivision of the shares had taken place at the beginning of 1979 and the corporation had paid the full preferential dividends of $.10 per share on the Class B Preferred shares in 1980 and 1979, the pro-forma fully diluted earnings per share (before extraordinary item) on the Class A Common shares would have been $.90 per share ($.74 in 1979) and on the Class B Preferred shares $.99 per share ($.84 in 1979).

Combined fully diluted earnings per share (before extraordinary item) for one Class A Common and one Class B Preferred share would be $1.89 in 1980 ($1.58 in 1979).

5. Other information

Operating results for the year include a $411,000 non-taxable gain on cancellation of preferred share indebtedness together with a $450,000 (after-tax) write-down of National Scientific's educational and scientific inventory which was necessitated by the recognition of declining markets for certain of these products.

6. Fixed assets

	1980			1979 (as restated — note 11(a))
	Cost	Accumulated depreciation and amortization	Net	Net
Land	$ 37,000		$ 37,000	$ 41,000
Buildings	348,000	$ 55,000	293,000	267,000
Equipment and furniture	8,381,000	3,912,000	4,469,000	3,798,000
Leasehold improvements	2,425,000	1,115,000	1,310,000	938,000
	$11,191,000	$5,082,000	$6,109,000	$5,044,000

7. Other assets

	1980	1979
Long term investments at cost less allowance for doubtful realization:		
Debenture and notes receivable	$ 45,000	$139,000
Investment in shares of and advances to other companies	360,000	411,000
	405,000	550,000
Debt issue expense less amortization	178,000	185,000
Other	24,000	25,000
Deferred foreign exchange loss less amortization	—	40,000
	$607,000	$800,000

8. Acquisitions

During the year, the corporation's U.S. subsidiary acquired five medical laboratories in the United States for a total cash consideration of $942,000. Of the total purchase price, $528,000 was ascribed to net assets and $414,000 to goodwill. The purchase price includes the present value of currently determinable payments, which payments are based on the future business volumes of the acquired laboratories.

In addition, payments of $184,000 were made during the year in connection with employment and consulting agreements that were entered into by the corporation as a result of certain previous acquisitions. These payments were accounted for as an additional cost of purchase.

9. Segmented information

In accordance with section 47 of the Canada Business Corporations Act Regulations, the directors have determined that the corporation operates within the one dominant health care services segment.

The corporation has been carrying on business in Canada since 1969 and recently expanded into the United States. Although these United States laboratory operations are still in the early stages of development, they constitute approximately 25% of the corporation's total assets and 21% of total revenues and were marginally profitable in 1980 after fully expensing start-up costs. These operations generated losses in previous years.

10. Income taxes

The apparent tax rate of 46% in the statement of income for 1980 is approximately 8% lower than the corresponding percentage in 1979. This decrease principally results from (a) the inclusion of the non-taxable gain of $411,000 (note 5) in 1980 income and (b) losses of certain subsidiaries included in 1979 income for which no future tax reduction had been recorded.

Loss carry forwards (for which no future tax benefit has been recorded in the accounts), many of which arose prior to acquisitions, amount to $1,468,000 and expire as follows: 1982 — $81,000; 1983 — $240,000; 1984 — $242,000; 1985 — $98,000 and 1986 — $807,000. In addition, certain U.S. companies have unused investment tax credits of $141,000 available to reduce future income taxes payable which have not been recognized in the accounts. The major portion of these credits expire in the years 1984 to 1987.

11. Leases and commitments

(a) Capital leases -
During the year, the corporation retroactively adopted the policy of recording capital leases. Where material, prior year's financial statements have been restated to reflect this change in accounting principle.

At October 31, 1980, fixed assets include equipment and vehicles acquired under capital leases amounting to $694,000 ($641,000 in 1979) at cost and accumulated depreciation of $274,000 ($222,000 in 1979).

Future lease payments required under capital leases at October 31, 1980 are as follows:

1981	$266,000
1982	188,000
1983	71,000
1984	17,000
Total future minimum lease payments	542,000
Less imputed interest	122,000
Present value of minimum lease payments	$420,000

(b) Operating leases -
Under premise and equipment leases entered into by the corporation and its subsidiaries to October 31, 1980, the corporation is obliged to make minimum payments of approximately $1,689,000 in 1981, $1,386,000 in 1982, $1,132,000 in 1983, $882,000 in 1984, $631,000 in 1985 and $1,726,000 thereafter.

(c) Commitments -
In 1979, the corporation entered into certain royalty, consulting and exclusivity agreements calling for minimum payments of $188,000 in 1981 and $238,000 in 1982. In addition, if certain events occur prior to 1983 certain agreements will be extended to 1989 requiring minimum payments of $150,000 per year.

12. Statutory information

At the close of business on October 31, 1980, the corporation and its wholly-owned subsidiary corporation, All Services Laboratories Canada Limited, amalgamated under the provisions of the Canada Business Corporations Act continuing as one corporation under the name, MDS Health Group Limited.

A Ten Year Financial Summary

Years ended October 31– Figures in thousands of dollars

	1980	1979	1978	1977	1976	1975	1974	1973	1972	1971
Statement of Income										
Net revenues	47,702	39,698	32,820	20,494	19,870	18,645	14,576	9,532	6,608	4,908
Income before extraordinary items	2,812	2,240	2,085	1,089	957	938	784	667	337	143
Net income for the year	2,812	2,126	2,085	1,089	995	938	382	586	624	351
Balance Sheet										
Working capital	9,277	8,702	4,904	2,835	912	1,514	1,208	1,134	687	113
Fixed assets (net)	6,109	5,044	3,470	2,053	2,144	2,139	1,728	977	750	567
Other assets (including goodwill)	6,749	6,415	5,561	5,063	3,895	3,646	3,618	3,703	3,122	2,749
Total assets	30,426	28,660	21,415	13,632	10,576	11,469	9,769	7,471	6,117	4,353
Long term debt	10,552	10,880	6,673	3,756	1,660	1,702	1,846	1,544	892	1,485
Shareholders' equity	11,404	9,120	6,677	6,186	5,269	5,527	4,600	4,234	3,667	1,944
Source of Funds (selected items)										
Working capital from operations	4,411	3,354	2,741	1,365	1,305	1,253	1,069	819	454	228
Issue of long term debt	—	4,198	1,000	2,540	600	—	425	700	—	—
Issue of shares	—	766	567	1	4	6	1	66	1,000	275
Application of Funds (selected items)										
Purchase of fixed assets	2,677	2,580	1,940	386	480	854	987	380	297	164
Investment in subsidiaries and divisions	598	225	(92)	227	(8)	—	351	335	140	4
Dividends on Class A Common and Class B Preferred shares	471	392	192	156	167	—	—	—	—	—
Dividends on Class C shares	57	57	20	17	17	17	17	19	22	—
Reduction in long term debt	328	402	829	443	792	144	204	248	603	203
Purchase of shares for cancellation	—	—	1,949	—	1,073	—	—	—	—	—
Per Share* ($ per share)										
Earnings fully diluted and before extraordinary items	1.89	1.58	1.28	.64	.55	.43	.36	.30	.15	.07
Earnings fully diluted and after extraordinary items	1.89	1.50	1.28	.64	.57	.43	.17	.26	.28	.19
Number of shares outstanding at end of period (000's)										
Common (before subdivision)	—	1,344	1,269	1,674	1,673	2,152	2,147	2,146	2,107	1,888
Class A Common	1,339									
Class B Preferred	1,366									
Class C Preferred	134	142	142	42	42	42	42	42	55	55

*Combined total of Class A Common and Class B Preferred in 1980.

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